

CREDIT OPINION

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Cambridge (City of) MA

Update to credit analysis

Summary

[Cambridge](#) (Aaa stable) benefits from a large and diverse tax base that continues to experience strong growth. The city's economy is driven by the presence of [Harvard University](#) (Aaa stable) and [Massachusetts Institute of Technology](#) (MIT, Aaa stable) and the impressive research and development sector. Cambridge's financial position is strong with very healthy reserves and liquidity that are maintained by formal policies and conservative fiscal management. Both the debt burden and long term liabilities for pension and OPEB are conservatively managed and are expected to remain manageable.

Credit strengths

- » Large tax base anchored by institutional presence and robust commercial sector
- » Healthy financial position guided by formal policies and strong fiscal management
- » Ample operating flexibility with excess levy capacity under Proposition 2½
- » Low adjusted net pension liability that will decline further given annual pension contributions above the tread water metric

Credit challenges

- » High regional cost of living and cost of business
- » Taxpayer concentration in research and development

Rating outlook

The stable outlook reflects the city's strong fiscal management that is committed to maintaining a healthy financial position given conservative multi-year budget forecasting and adherence to formally adopted fiscal policies. The outlook also incorporates the stabilizing presence of Harvard University and MIT as well as the long historical trend of positive valuation growth in the tax base.

Factors that could lead to an upgrade

- » Not applicable

Factors that could lead to a downgrade

- » Material growth in the debt burden or unfunded long term liabilities
- » Significant deterioration in the tax base or weakening of the local economy

» Trend of operating deficits that lead to significant reduction in cash and reserves

Key indicators

Exhibit 1

Cambridge (City of) MA	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value (\$000)	\$29,733,818	\$39,570,829	\$39,570,829	\$49,449,366	\$49,449,366
Population	108,757	110,893	115,665	116,632	116,632
Full Value Per Capita	\$273,397	\$356,838	\$342,116	\$423,978	\$423,978
Median Family Income (% of US Median)	159.0%	167.1%	170.7%	174.5%	174.5%
Finances					
Operating Revenue (\$000)	\$560,698	\$594,597	\$632,640	\$658,347	\$698,158
Fund Balance (\$000)	\$299,408	\$330,342	\$366,134	\$384,406	\$356,931
Cash Balance (\$000)	\$333,793	\$363,415	\$401,145	\$422,033	\$394,925
Fund Balance as a % of Revenues	53.4%	55.6%	57.9%	58.4%	51.1%
Cash Balance as a % of Revenues	59.5%	61.1%	63.4%	64.1%	56.6%
Debt/Pensions					
Net Direct Debt (\$000)	\$405,399	\$417,765	\$457,347	\$492,508	\$482,543
3-Year Average of Moody's ANPL (\$000)	\$832,179	\$853,029	\$867,947	\$823,339	\$799,364
Net Direct Debt / Full Value (%)	1.4%	1.1%	1.2%	1.0%	1.0%
Net Direct Debt / Operating Revenues (x)	0.7x	0.7x	0.7x	0.7x	0.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.8%	2.2%	2.2%	1.7%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.5x	1.4x	1.4x	1.3x	1.1x

As of June 30 fiscal year end

Sources: Moody's Investors Service and Cambridge's audited financial statements

Profile

Cambridge is a large, diverse urban community that neighbors the City of Boston (Aaa stable) across the Charles River. The city's population totals approximately 116,600 and its economy and tax base are anchored by two world renowned higher education institutions.

Detailed credit considerations

Economy and tax base: strong economy and tax base anchored by world renowned institutions

Cambridge's economy will continue to benefit from the presence of Harvard and MIT which together enroll 33,000 students and provide employment equivalent to 21,000 full-time positions (roughly 18% of the city's workforce). In addition, the city is home to a vibrant commercial sector including biotechnology and pharmaceutical industries. Together the universities and mentioned industries comprise around 60% of the jobs provided by the top 25 employers. The Top 10 taxpayers are concentrated, representing 24% of 2021 assessed value. Although MIT with its significant taxable property, is the largest taxpayer, representing 9.6% of the city's base. Overall, commercial property pays 65% of the city's fiscal 2021 property tax levy. The city also benefits from a commercial property tax rate of \$11.85 per \$1,000 of value, which is well below Boston and other large surrounding cities.

The \$63.5 billion tax base (2021-22 equalized value) is large and will continue to grow given strong housing demand and the strength of the overall economy continuing to drive the commercial sector. The equalized value increased 28.4% since 2019's certification. Additionally, the 2021 assessed value grew by 9.6%, bringing the five year compound annual growth rate to 12.2%. The city is estimating that the impacts from the coronavirus pandemic will impact 2022 assessed value resulting in a projected decline of 3.2% in

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which new construction value will help to offset a 1% decline in the residential sector and 9% decline in the commercial sector. Positive growth is expected to return in 2023.

Resident income and wealth levels are very strong relative to the commonwealth and US medians. The unemployment rate has increased to 4.6% as of December 2020 but is well below the commonwealth's 7.1% and US's 6.5%. The city's unemployment rate was at a very low 1.3% at the same time last year.

Financial operations and reserves: healthy financial position is expected to remain due to conservative budgeting and robust revenue growth

The city's financial position will likely remain strong over the near term given ample liquidity, robust revenue growth and operating flexibility under the tax levy limit that are maintained by conservative fiscal management. The fiscal 2020 audited financials reflect the first year of declines in general fund reserves in many years due to transfers out to cover capital projects. The general fund produced \$38.6 million in excess revenues over expenditures due mostly to conservative expense budgeting. The city transferred \$87.9 million out of the general fund including \$69.9 million to the capital projects fund and \$15 million deposit into the affordable housing trust fund. The transfers out resulted in a decline in general fund reserves. The available general fund balance declined to \$356.9 million representing a still very healthy 51.1% of revenue. The primary revenue source is property taxes representing 63% of general fund revenue in fiscal 2020. The largest expenses are education and public safety representing 33% and 20% of 2020 expenditures.

The fiscal 2021 operating budget increased by 5.1% or \$34.7 million over the prior year driven by salaries, health insurance and pension costs. The budget is balanced with a 7.85% increase in the tax levy and \$22 million of free cash used to lower the tax rate. The city also continues to appropriate reserves toward capital, funding the OPEB trust and other one-time costs. Year-to-date operations are on budget.

The city's fiscal 2021-25 budget projections indicated balanced annual operations using conservative assumptions. The expense projections include a 2.5% annual increase in salaries in most years, pension contribution will increase by 12.1% in 2022 annually and education costs increase by the value of a 6.5% property tax levy increase as a funding source for their budget. The revenue projections include funding of state aid in line with the current budget recommendation for next year and flat thereafter, and an average annual tax levy increase of 7.5%. The city also has \$187 million of unused levy capacity, equal to 27% of general fund revenue. This provides significant operating flexibility under Proposition 2½ that is not available to most municipalities in Massachusetts given the need to levy to the tax levy limit each year.

Liquidity

Cash and investments at the end of fiscal 2020 equaled \$394.9 million or a strong 56.6% of general fund revenue. The cash position is not expected to materially change through fiscal 2021.

Debt, pension and OPEB liabilities: debt burden, pension and OPEB liabilities are expected to remain manageable

The debt and long term liabilities will remain manageable over the near term given conservative debt management and aggressive funding towards the city's unfunded pension liability. Including the 2021 issuance, the city has \$567.2 million in net direct debt equal to 0.9% of equalized value and 0.8 times general fund revenue is average and will remain manageable. The city's debt management policies include maintaining a debt to assessed value of less than 1.5%, gross debt service under 12.5% of operating expenses and 85% of principal retired in 10 years. The fiscal 2021-25 public investment program totals \$607.3 million, an increase of \$35.1 million from last year. Bond proceeds of \$421.7 million or 69% of the program will be the largest source of funding. The program includes a 200% increase in the fiscal 2021 capital budget to \$312 million due to larger bond issuance to cover two large school projects.

Legal security

The city's general obligation unlimited tax bonds are secured by the city's full faith and credit, general obligation unlimited tax pledge because the entire amount of debt service has been excluded from the tax levy limits of Proposition 2½. The city's general obligation limited tax bonds are secured by the city's full faith and credit, general obligation limited tax pledge because not all of the debt service has been excluded from the tax levy limitations of Proposition 2½. There is no distinction between the unlimited and limited tax bonds due to the city's full faith and credit pledge as well as the city's ability to override the tax levy limit.

Debt structure

All of the city's debt is fixed rate with 85% of principal retired in 10 years. Fiscal 2020 debt service totaled \$74.3 million representing 11.3% of general fund expenses.

Debt-related derivatives

Cambridge is not party to any interest rate swaps or other derivative agreements.

Pensions and OPEB

Cambridge's pension and OPEB liabilities are larger than its bonded debt, but will likely decline in the coming years given very strong contribution practices. The city participates in the City of Cambridge Retirement System, a cost sharing multiple employer defined benefit retirement plan and makes annual required contributions based on its proportional share. The plan is likely to be fully funded by 2026. Additionally, the city's teachers participate in the Massachusetts Teachers Retirement System in which the city receives on-behalf payments toward the liability that is covered by the Commonwealth. The city also funds its OPEB liability on a pay-go basis and makes modest annual deposits to an OPEB trust. The table below summarizes the city's 2020 debt, pension and OPEB unfunded liabilities and contributions.

Exhibit 2

Cambridge's fiscal 2020 debt, pension and OPEB unfunded liabilities and contributions remain manageable

2020	Amount (\$ thousands)	% of Operating Revenues	Discount Rate
Operating Revenue	698,158		
Reported Net Pension Liability	183,560	26.29%	7.25%
Moody's Adjusted Net Pension Liability	912,206	130.66%	3.22%
Reported Net OPEB Liability	713,172	102.15%	3.67%
Moody's Adjusted Net OPEB Liability	736,553	105.50%	3.51%
Pension Contribution	34,956	5.01%	-
Pension Tread Water Gap [1]	-7,435	-1.06%	-
OPEB Contribution	22,193	3.18%	-
Net Direct Debt	482,543	69.12%	-
Debt Service	74,276	10.64%	-
Total Fixed Costs	131,425	18.82%	-

[1] A positive pension tread water gap reflects a pension contribution smaller than the amount required to prevent the unfunded liability from increasing if all plan assumptions are realized. A negative tread water gap reflects a contribution larger than the amount required to keep the unfunded liability from increasing if all assumptions are realized.

Source: Moody's Investors Service and Cambridge's audited financial statements

The city's 2020 pension contribution was equal to a strong 127% of the tread water indicator which is the amount required to keep the unfunded liability from increasing if all actuarial assumptions are realized. This level of funding has been similar to prior years with annual contributions over the last five years, 2016-20 averaging 132% of tread water.

ESG considerations

Environmental

Environmental risks are not material to the city's credit profile at this time. Moody's affiliate Four Twenty Seven indicates that Middlesex County in which the city resides has high exposure to hurricanes, medium exposure to extreme rainfall, water stress and sea level rise and low exposure to heat stress. The city is committed to addressing environmental risk associated with flooding and heat exposure. To date, the most comprehensive mitigation projects include improving natural barriers around the Alewife neighborhood as well as heat mitigation efforts through its urban canopy-public shade tree investment program. Longer term the city expects to release its Climate Change Preparedness and Resilience Plan by the end of calendar year 2021. The plan will include a net zero action plan for government, residential and commercial development. The plan was scheduled to be released in 2020 but has been delayed due to challenges related to the coronavirus pandemic.

Social

Cambridge leverages its strong credit profile by focusing on significant community initiatives. These initiatives currently include a robust bike ordinance, participatory budgeting that gives residents a voice in capital and other spending, the city providing a proportional share of funding towards the MBTA green line extension, and offering a small business personal property tax exemption. Additionally, the city continues to increase its funding towards affordable housing projects. In fiscal 2020 a supplemental appropriation of \$15 million was used to preserve 338 affordable housing units. In fiscal 2021 the city committed \$12.3 million of Community Preservation Act funding and \$15 million from the capital budget to the Affordable Housing Trust to finance the creation and preservation of new affordable housing.

Governance

The city's experienced management team is very strong, as evidenced by the maintenance of very healthy liquidity and reserves as well as adherence to formal fiscal policies, conservative multiyear budgeting and capital planning.

Massachusetts cities have an Institutional Framework score of "Aa", which is strong. The sector's major revenue source of property taxes, are subject to the Proposition 2 1/2 tax levy cap which can be overridden with voter approval only. However, the cap of 2.5% still allows for moderate revenue-raising ability. Expenditures primarily consist of personnel costs, as well as education costs for cities that manage school operations, and are highly predictable given state-mandated school spending guidelines and employee contracts. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed costs are generally less than 25% of expenditures. Fixed costs are driven mainly by debt service and pension costs. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching adjustments dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Cambridge (City of) MA

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$63,505,736	Aaa
Full Value Per Capita	\$544,497	Aaa
Median Family Income (% of US Median)	174.5%	Aaa
Notching Adjustments: ^[2]		
Institutional Presence		Up
Finances (30%)		
Fund Balance as a % of Revenues	51.1%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	11.9%	Aa
Cash Balance as a % of Revenues	56.6%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	12.7%	Aa
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	Aa
Notching Adjustments: ^[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.9%	Aa
Net Direct Debt / Operating Revenues (x)	0.8x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.3%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.2x	A
	Scorecard-Indicated Outcome	Aaa
	Assigned Rating	Aaa

[1] Economy measures are based on data from the most recent year available. [2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology. [3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Sources: Moody's Investors Service and US Census Bureau

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